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TO COUNTY ASSESSORS:

UNRELATED BUSINESS INCOME IN COLLEGE AND UNIVERSITY BOOKSTORES

This letter is in response to several inquiries relating to the property tax on student bookstores that generate "unrelated business taxable income."

As you recall, Chapter 1606 (Senate Bill 2407) effective January 1, 1989 amended Sections 202 and 203 to provide a property tax on the portion of a student bookstore, otherwise exempt, that generates unrelated business taxable income as defined in Section 512 of the Internal Revenue Code to the extent the property is:

"(1) Owned by an educational institution of collegiate grade or used by a nonprofit corporation operating a student bookstore affiliated with such an educational institution, and

"(2) Is primarily devoted to bookstore use that produces income that is taxable as unrelated business taxable income."

Let us first review the pertinent sections of the Internal Revenue Code:

"SECTION 511. IMPOSITION OF TAX ON UNRELATED BUSINESS INCOME  
OF CHARITABLE, ETC., ORGANIZATIONS

"[Section 511(a)]

"(a) CHARITABLE, ETC., ORGANIZATIONS TAXABLE AT CORPORATION RATES.--

"(1) IMPOSITION OF TAX.--There is hereby imposed for each taxable year on the unrelated business taxable income (as defined in Section 512) of every organization described in paragraph (2) a tax computed as provided in Section 11. In making such computation for purposes of this section, the term 'taxable income' as used in Section 11 shall be read as 'unrelated business taxable income.'

"(2) ORGANIZATIONS SUBJECT TO TAX.--

"(A) ORGANIZATIONS DESCRIBED IN SECTIONS 401(a) AND 501(c).--The tax imposed by paragraph (1) shall apply in the case of any organization (other than a trust described in subsection (b) or an organization described in Section 501(c)(1)) which is exempt, except as provided in this part or part II (relating to private foundations), from taxation under this subtitle by reason of Section 501(a).

"(B) STATE COLLEGES AND UNIVERSITIES.--The tax imposed by paragraph (1) shall apply in the case of any college or university which is an agency or instrumentality of any government or any political subdivision thereof, or which is owned or operated by a government or any political subdivision thereof, or by any agency or instrumentality of one or more governments or political subdivisions. Such tax shall also apply in the case of any corporation wholly owned by one or more such colleges or universities.

"SECTION 512. UNRELATED BUSINESS TAXABLE

"[Section 512(a)]

"(a) DEFINITION.--For purposes of this title--

"(1) GENERAL RULE.--Except as otherwise provided in this subsection, the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in Section 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in subsection (b).

"SECTION 513. UNRELATED TRADE OR BUSINESS

"[Section 513(a)]

"(a) GENERAL RULE.--The term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by Section 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under Section 501 (or, in the case of an organization described in Section 511(a)(2)(B), to the exercise or performance of any purpose or function described in Section 501(c)(3)), except that such term does not include any trade or business--

"(2) which is carried on, in the case of an organization described in Section 501(c)(3) or in the case of a college or university described in Section 511(a)(2)(B), by the organization primarily for the convenience of its members, students, patients, officers, or employees.

Reading from these statutes, it would appear that bookstores in state colleges and universities are not subject to the unrelated business income tax in accordance with Internal Revenue Code 513(a)(2). However, we would recommend inquiry of the Internal Revenue Service on a case-by-case basis if you question whether certain merchandise held for sale is subject to the unrelated business income tax. To recap: unrelated trade or business means any trade or business the conduct of which is not substantially related to the performance by such organization of its charitable, educational purposes...except that such term does not include any trade or business...(2) which is carried on, in the case of our organization described in Section 501(c)(3) or in the case of a college or university described in Section 511(a)(2)(B), by the organization primarily for the convenience of its members, students, patients, officers, or employees....

Similarly, if the organization operating the bookstore in a private college or university is a 501(c)3 organization, it would appear that bookstore would also be excluded from the tax on unrelated business income under Section 511(a)(2)(A) and 513(a)(2) when the business is primarily for the convenience of its members, students, patients, officers, or employees. Again, inquiry of the Internal Revenue Service should be made on a case-by-case basis.

In summary, if you have questions on the taxability of certain merchandise held for sale in college or university bookstores or by other claimants, contact the Internal Revenue Service. Other questions should be directed to the Exemptions Unit at (916) 445-4982.

Sincerely,



Verne Walton, Chief  
Assessment Standards Division

VW:wpc  
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